Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

COMMENTS OF IOWA TELECOMMUNICATIONS SERVICES, INC. (D/B/A IOWA TELECOM)

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October 15, 2004

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COMMENTS OF IOWA TELECOMMUNICATIONS SERVICES, INC.
(D/B/A IOWA TELECOM)

Iowa Telecommunications Services, Inc. (d/b/a Iowa Telecom) ("Iowa Telecom") hereby submits the following Comments in response to the Federal-State Joint Board on Universal Service's ("Joint Board's") Public Notice seeking comment on certain of the Federal Communications Commission's ("Commission's") rules relating to high-cost universal service support.[1]

I. INTRODUCTION AND SUMMARY

Iowa Telecom began business on June 30, 2000, when it acquired the Iowa operations of GTE Midwest Incorporated ("GTE"). Today, Iowa Telecom is the largest provider of wireline local exchange telecommunications services to residential and business customers in rural Iowa, serving 440 communities (294 exchanges) across the state. While Iowa Telecom is the second largest local exchange carrier ("LEC") in Iowa, it also serves less than one-seventh of one percent of incumbent and competitive LEC access lines nationally. Iowa Telecom provides

[1] *Federal-State Joint Board on Universal Service Seek Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, Public Notice, CC Docket No. 96-45, FCC 04J-2 (rel. Aug. 16, 2004)("*Notice*").

services to more than 253,000 access lines in Iowa as an incumbent LEC ("ILEC"). In addition to its basic local telephone service, Iowa Telecom provides long distance service, dial-up and digital subscriber line Internet access, and other communications services. Iowa Telecom has approximately 620 full-time employees and earned $205,509,000 in revenue from all sources in 2003.

Iowa Telecom is the smallest carrier subject to federal price cap regulation – serving no community with a population greater than 16,000.[2] In fact, in over 80 percent of its exchanges, Iowa Telecom serves fewer than 1,000 access lines. Given these circumstances, Iowa Telecom believes that it has a unique perspective on federal universal service policy, and offers these Comments to assist the Joint Board in its development of a sound record on which to base its recommendations.

Iowa Telecom finds itself in a unique situation resulting from unintended consequences of current universal service rules. Although Iowa Telecom is one of the nation's most rural carriers (with an average teledensity of only 12.70 access lines per square mile, as compared to the average rural company teledensity of 42.09 access lines per square mile),[3] it receives no high-cost universal service support. Iowa Telecom receives no high-cost support because the prior owners of Iowa Telecom's exchanges made relatively little investment in network infrastructure and because the "book" or "embedded" costs inherited from the prior owners are too low to qualify Iowa Telecom for rural carrier support. This proceeding offers the opportunity to remedy this flaw in the existing rules governing universal service.

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[2] Newton, Iowa, with a population of 15,579 according to the 2000 U.S. Decennial Census, is the only community larger than 10,000 served by Iowa Telecom's ILEC operations.

[3] *See* RURAL TASK FORCE, THE RURAL DIFFERENCE: RURAL TASK FORCE WHITE PAPER 2, Supporting Data File RTfdat3.xls (2000)("*RTF White Paper 2*")(available at <http://www.wutc.wa.gov/rtf/rtfpub.nsf?open>).

Carriers receiving high-cost support for their rural operations include some of the nation's smallest and largest carriers. These carriers receive support under rules which differ, depending on the company's designation as "rural or "non-rural." Whether rural or non-rural, these carriers receive such high-cost support to build the network infrastructure used to deploy advanced services for the benefit of their customers.

Iowa Telecom and its customers have the same desire to deploy advanced services as do carriers receiving high-cost support. While Iowa Telecom has made and intends to continue making important network improvements, the fact remains that there is more left to do to Iowa Telecom's network than there is to the networks of many long-time high-cost universal service support recipients. Today, Iowa Telecom's forward-looking costs to deploy such services are at least as large, and probably larger, than those of carriers receiving high-cost support. The embedded cost standard used to determine eligibility for rural high-cost support, which was intended to help rural carriers qualify for support, actually punishes carriers like Iowa Telecom, and the customers served by such carriers.

Despite Iowa Telecom's decidedly rural nature, its desire to deploy advanced services and its high costs of doing so, Iowa Telecom receives no high-cost support because it is trapped in the "rural" high-cost support program which continues to link eligibility to embedded costs. As Iowa Telecom's situation illustrates, current Commission rules have the unintended consequence of precluding carriers such as Iowa Telecom from receiving high-cost support to the detriment of the customers served by such carriers. The current rules should be changed to provide more flexibility in the method used to determine qualification for high-cost support in order to eliminate this unintended consequence.

As discussed below, a one-size-fits-all approach is not ideal universal service policy – a matter recognized by Congress, the Commission, and the Joint Board. Today's universal service rules, however, are too rigid and inflexible. As a result, rural carriers such as Iowa Telecom, which for historical reasons have particularly low embedded costs but heightened future investment needs, are unable to qualify for support sufficient to provide for improved and advanced services. Rural local exchange carriers, and particularly price cap rural local exchange carriers such as Iowa Telecom, should be permitted to opt out of the rural high-cost support program and, instead, be allowed to participate in the non-rural high-cost support program. Carriers participating in the rural high-cost program also should be permitted the option of demonstrating their costs using forward-looking economic cost ("FLEC"), consistent with the method used by carriers participating in the non-rural fund, since, as acknowledged by the Commission, this methodology most accurately establishes the level of support needed for universal service.

II. RURAL TELEPHONE COMPANIES PLAY A SPECIAL ROLE UNDER THE TELECOMMUNICATIONS ACT OF 1996 AND COMMISSION REGULATION.

Both the Communications Act of 1934, as amended ("Act"), and Commission regulations contain significant provisions aimed specifically at protecting the ability of rural telephone companies to provide the widest possible array of high quality telecommunications services at the most affordable rates possible. With regard to the Act, these provisions include new sections established by the Telecommunications Act of 1996[4] ("1996 Act") such as Sections 214(e)(2) (permissive designation of eligible telecommunications carriers in rural areas), 251(f) (rural

[4] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. § 151 et seq. ("1996 Act").

exemption to ILEC interconnection obligations), 253(f) (preemption exemption for enforcement of Section 214), and 254(b)(3) (universal service support for rural and high-cost areas).[5] Clearly, Congress intended for rural carriers to be treated differently than non-rural carriers. Congress also intended the transition to a competitive environment in rural areas to be taken with more deliberation and caution in order to preserve the ability of the Nation's rural telephone companies to provide affordable high quality telecommunications service to rural Americans. These provisions were created for the benefit of rural consumers and the carriers that serve them.

The Commission has heeded the wishes of Congress with respect to treatment of rural carriers in the context of implementation of Section 254 of the Act. In its 1997 *First Report and Order*, the Commission concluded that FLEC was the appropriate means of determining the level of universal service support.[6] At the same time, however, the Commission acknowledged that "[f]or many rural carriers, universal service support provides a large share of the carriers' revenues, and thus, any sudden change in the support mechanisms may disproportionately affect rural carriers' operations."[7] The Commission therefore adopted the Joint Board's recommendation to allow rural carriers to continue to receive support based on embedded cost until at least May 2000.[8] The Commission noted, however, that "[o]nce a forward-looking economic cost methodology for non-rural carriers is in place, we shall evaluate mechanisms for

[5] 47 U.S.C. §§ 214(e)(2), 251(f); 253(f), 254(b)(3).

[6] *See, e.g.*, *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, ¶ 224 (1997) ("*First Report and Order*") (subsequent history omitted)("We agree with the Joint Board's recommendation that the proper measure of cost for determining the level of universal service support is the forward-looking economic cost of constructing and operating the network facilities and functions used to provide the supported services as defined per section 254(c)(1)." *Id.*).

[7] *Id.* at ¶ 294.

[8] *Id.* The Commission further concluded that "Consistent with our approach towards non-price-cap ILECs in access charge reform, we conclude that rural carriers' unique circumstances warrant our implementation of separate mechanisms." *Id.* at ¶ 295.

rural carriers. Rural carriers will shift gradually to a forward-looking economic cost methodology to allow them ample time to adjust to any changes in the support calculation."[9] In other words, the Commission concluded that FLEC was the ideal methodology on which to base rural carrier's universal service support, but that implementing such a methodology (as it stood at the time) immediately would fail to take into account the cost structure of rural carriers and would therefore not be good public policy.

Four years later, the Commission adopted a new high-cost support plan for rural carriers in its *RTF Order*.[10] The Commission concluded that "adopting a modified embedded cost mechanism for rural carriers for a five-year period strikes a fair and reasonable balance among the goals and principles enumerated in section 254 of the Act."[11] The Commission also stated, however, that it

> intend[s] to develop over the next few years a long-term universal service plan for rural carriers that is better coordinated with the non-rural mechanism. In particular, we intend to develop a long-term plan that better targets support to carriers serving high-cost areas, while at the same time recognizing the significant differences among rural carriers, and between rural and non-rural carriers.[12]

Through the *Notice*, the Joint Board is seeking comment on the appropriate nature of such a long-term plan. Iowa Telecom believes it is important for the Commission to continue on its path toward universal service reform for rural and non-rural carriers. Iowa Telecom discusses

[9] *Id.* at ¶ 294.

[10] *Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket Nos. 96-45, 00-256, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, 16 FCC Rcd 11244 (2001) ("*RTF Order*").

[11] *Id.* at ¶ 8.

[12] *Id.*

below changes that it seeks for the Joint Board to recommend to the Commission in order to address known shortcomings in the current regulations.

III. THE JOINT BOARD SHOULD RECOMMEND THAT THE COMMISSION PERMIT RURAL CARRIERS GREATER FLEXIBILITY IN DEMONSTRATING THEIR COSTS, AS WELL AS IN ELECTING THE UNIVERSAL SERVICE HIGH-COST PROGRAM IN WHICH THEY PARTICIPATE.

The underlying premise behind separate treatment of rural and non-rural carriers is that one size does not fit all. The Joint Board acknowledges this to a great degree and asks numerous detailed questions regarding whether this concept should be expanded further by possibly creating a spectrum of regulatory categorizations for LECs, particularly rural LECs.[13]

Iowa Telecom is a perfect example of a carrier that is at a precise intersection of the two universal service regimes. On one hand, it is a price cap carrier, albeit the smallest one, with interstate access charges regulated in the same manner as behemoths such as Verizon and SBC. On the other hand, it serves an average of 858 access lines per exchange, and thus Iowa Telecom's service areas are, by virtually any standard, very rural areas. At the regulatory intersection at which Iowa Telecom finds itself, however, Iowa Telecom is ineligible for high-cost support in the rural program and cannot participate in the non-rural high cost support program. Unfortunately for Iowa Telecom's customers, this "intersection" is one from which there is no escape today.

In order to provide sufficient universal service support for investment in rural telecommunications infrastructure by rural carriers such as Iowa Telecom, the Joint Board should recommend that the Commission adopt flexible rules regarding the manner in which such

[13] *See, e.g., Notice* at ¶¶ 11-15.

carriers participate in the Commission's universal service high-cost support programs. At the heart of these options is the notion that carriers should be permitted to demonstrate their costs for high-cost support program purposes based on FLEC, particularly a version of which that takes into account the unique aspects of rural networks served by price cap carriers. Iowa Telecom believes that this should be achieved through two new options for rural carriers. First, the Joint Board should recommend that the Commission permit rural LECs to opt out of the rural high-cost support program and, instead, participate in the non-rural high-cost support program. Second, rural carriers electing to remain in the rural high-cost program should have the option of demonstrating their costs using FLEC as an alternative to embedded costs.

In the interest of fairness, however, Iowa Telecom believes that any election for a study area to be treated as non-rural should be a "one-way" decision that cannot be reversed for so long as the regulatory regime that required the election persists. Similarly, any election by a rural carrier to have its costs within a study area to be determined on the basis of FLEC, as opposed to embedded costs, should also be irreversible.

A. Carriers Should Be Permitted the Option of Demonstrating Their Costs for High-Cost Support Program Purposes Based on FLEC.

As discussed in more detail below, Iowa Telecom recommends that the Joint Board provide rural carriers two means by which they can receive high-cost support based on their FLEC: (1) participating in the non-rural high-cost support program in which all carriers are required to use FLEC; and (2) continuing to participate in the rural high-cost support program but by demonstrating their costs using FLEC rather than embedded cost. Both options have one thing in common – rural carriers would be permitted to qualify for and receive high-cost support based on FLEC rather than embedded cost.

The Commission has already acknowledged that FLEC is the desirable method by which all carriers, including rural carriers, should demonstrate their costs for high-cost support purposes. Permitting rural carriers participating in the rural high-cost support program the option of qualifying for high-cost support based on FLEC (under either the rural or non-rural regime) will serve as a strong inducement to investment in rural networks.

Currently, Iowa Telecom's embedded costs are less than those required to qualify for high-cost support. This does not mean that it is less expensive for Iowa Telecom to provide high-quality telecommunications services, including advanced services, at affordable rates to the residents of rural Iowa. It clearly is just as costly for Iowa Telecom to provide such services as it is for other carriers which do qualify for universal service support. The high-cost support that Iowa Telecom currently receives for any additional investment in its network, however, is zero as a result of the previous "book" investment levels of the prior owner of Iowa Telecom's exchanges. Iowa Telecom's inability to receive high-cost support is in spite of the fact that Iowa Telecom's costs of upgrading its network are great. Given Iowa Telecom's current inability to receive support based on FLEC (the Commission's preferred method of determining the eligibility for and level of high cost support), Iowa Telecom and similarly situated rural carriers cannot financially justify making all of the significant jurisdictionally interstate investments in their networks necessary to be eligible for support based on book cost, including safety net support. Penalizing customers who reside in areas where prior exchange owners chose not to invest is surely not the intended result of the universal service program established by Congress.

Critics may argue that there is no guarantee that rural telephone companies receiving FLEC-based high-cost support will actually expend such money on the provision of supported services. Iowa Telecom believes this is non-persuasive. There is no guarantee that any

companies today use their high-cost support for the purposes envisioned by Section 254 of the Act. In this regard, the Joint Board may wish to consider the degree to which such support is used to subsidize rural telecommunications service that is offered at a far lower price than in non-supported areas or to support competitive entry in other markets. Iowa Telecom believes sufficiently in the importance of this issue that it would support establishment of a rule requiring a demonstration that high-cost support has been invested in an appropriate manner, and thus is not used to subsidize rates to levels below those offered by providers of comparable service in areas that do not receive such support.

B. The Joint Board Should Recommend that the Commission Permit Rural LECs to Opt Out of the Rural High-Cost Support Program and, Instead, Participate in the Non-Rural High-Cost Support Program.

The Commission created the rural high-cost regime for the benefit of rural carriers. If a rural LEC, particularly a rural price cap LEC that meets the definition of "rural telephone company" finds it in its and its customers' interest,[14] to be treated as a non-rural telephone company for the purpose of the Commission's high-cost support programs, the Commission should permit it to opt out of the rural high-cost support regime in favor of the non-rural regime. If the rural high-cost support regime does not create the proper inducements for a particular rural carrier to invest in one of its study areas, Commission rules should not bind such carriers to the very regime created for that carrier's benefit. Rather than recommend a one-size-fits-all rule applicable to carriers meeting the definition of "rural," the Joint Board should recommend that the Commission provide otherwise "rural" carriers who fall between the regulatory cracks be

[14] Iowa Telecom and its customers both desire and deserve the same ultimate outcome in this regard. Iowa Telecom seeks universal service support to enhance its infrastructure investment to provide the highest service quality and widest variety of affordable services to its customers, while Iowa Telecom's customers seek to be offered such high-quality, varied, and affordable services.

afforded appropriate regulatory flexibility. Rural price cap carriers, in particular, should be permitted to participate in the FLEC-based non-rural high-cost support program. Permitting carriers to self-determine when they no longer require special rural high-cost support protections established for their benefit allows the Joint Board and the Commission to focus better on the needs of the remaining carriers in the rural program.

C. Rural Carriers Electing to Remain in the Rural High-Cost Program Should Have the Option of Demonstrating Their Costs Using FLEC As an Alternative to Embedded Costs.

Carriers meeting the definition of "rural," however, should not be required to exit the rural high-cost support program in order to receive "sufficient" high-cost support guaranteed by a statute that, among other things, grants special protections to rural carriers. Carriers participating in the rural high-cost program should have the option of demonstrating their costs using FLEC as an alternative to embedded costs.

To determine eligibility for the rural high-cost support program, the Commission must determine which carriers are rural carriers for universal service purposes. In the *Notice*, the Joint Board seeks comment on the extent to which the Commission should continue to use the definition of "rural telephone company" in Section 3(37) of the Act for universal service purposes.[15] Iowa Telecom believes that the statutory definition of "rural telephone company" strikes a reasonable balance between the public policy need for such a definition and administrative simplicity including, as necessary, an evaluation both of the carrier's size and the characteristics of the area served by such carrier. Section 3(37) of the Act states that a LEC is a "rural telephone company" if it engages in one of four types of activities:

[15] *Notice* at ¶¶ 8-17.

(A) provides common carrier service to any local exchange carrier study area that does not include either–
  (i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
  (ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993
(B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;
(C) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or
(D) has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.[16]

Iowa Telecom clearly meets the definition of "rural telephone company" because none of its access lines are in communities of 50,000.[17] Further, Iowa Telecom serves fewer than 1,000 access lines in over 80 percent of its exchanges, and does not serve more than 12,000 access lines in any of its exchanges.

In the *Notice*, the Joint Board seeks comment on whether a definition of "rural telephone company" for the purpose of the high-cost support program should apply to aggregations of study areas and holding companies.[18] So long as the Commission maintains Subsection (D) (providing less than 15 percent of a carrier's access lines in communities of more than 50,000) as an independent means of meeting the definition of "rural telephone company," Iowa Telecom does not object to any such aggregation. There should be no doubt that a carrier with nearly all of its customers in very small towns, and none in towns larger than 16,000, should be considered rural.

[16] *Id.*

[17] This includes communities with populations of 50,000 either before or after February 8, 1996, the date of enactment of the 1996 Act.

[18] *Notice* at ¶¶ 12-13.

Just as there are is no public policy justification for requiring a carrier to participate, to its own detriment, in a regime intended for the carrier's own benefit, there is no justification for requiring rural telephone companies participating in the rural high-cost support program to demonstrate their costs based on embedded costs, as opposed to FLEC. As discussed above, the Commission has already acknowledged that FLEC is the desirable method by which all carriers, including rural carriers, should demonstrate their costs for high-cost support purposes. Iowa Telecom believes that it is important for the Joint Board to recommend that the Commission to permit rural telephone companies voluntarily to demonstrate their costs based on the Commission's preferred FLEC methodology.

The Joint Board need not be concerned that permitting carriers to make the elections proposed by Iowa Telecom will result in an inefficient increase in the size of the universal service program. Most importantly, the Joint Board should recognize, as a fundamental matter of public policy, that the communities served by Iowa Telecom are as deserving of high-cost support as are the communities served by carriers receiving high-cost support today. Certainly, rural customers served by such carriers are equally entitled to advanced telecommunications services and infrastructure. Support to carriers such as Iowa Telecom is not sufficient under current regulations, is entirely inconsistent with the support provided to other rural and non-rural carriers, and conflicts with the public policy of advanced service deployment in rural areas.

D. The Commission's Rules Regarding Rural Carrier FLEC Demonstrations Must Take Into Account the Unique Characteristics of Rural Networks.

As discussed above, the Commission has already acknowledged the potential drawbacks to applying a large non-rural carrier model to rural carrier networks. Over the past two years, Iowa Telecom has endeavored to develop a method of determining FLEC for rural carriers such

as Iowa Telecom. Such a FLEC study was the basis in part for the Commission's approval last year of Iowa Telecom's modification to its average traffic-sensitive interstate interexchange access charge rate.[19] The FLEC study submitted in that proceeding was the result of the Commission's order requiring Iowa Telecom to submit such a study.[20]

Iowa Telecom elaborated further on the principles that should underlie a rural FLEC study in its joint comments with Valor Telecommunications, LLC ("Valor") in response to the Commission's 2003 Notice of Proposed Rulemaking concerning pricing of unbundled network elements ("*Joint UNE Pricing Comments*"),[21] which are included herein as Attachment A. In its *Joint UNE Pricing Comments*, Iowa Telecom discussed a number of necessary modifications to the Commission's TELRIC methodology necessary to best represent mid-sized and rural carrier's FLEC. In its *Joint TELRIC Comments*, Iowa Telecom noted, for example, that a methodology that estimates the cost of an efficient rural network by applying fill factors derived from equally efficient but substantially denser urban networks will understate the cost of the rural network.[22] This is supported by the Rural Task Force, which has observed that rural carriers serve far fewer lines per local switch (on average about 1,250 lines) than non-rural

[19] *Iowa Telecommunications Services, Inc., Tariff FCC No. 1, Transmittal No. 31*, Order Terminating Tariff Investigation, 18 FCC Rcd 18907 (2003).

[20] *See Petition for Forbearance of Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom Pursuant to 47 U.S.C. 160(c) from the Deadline for Price Cap Carriers to Elect Interstate Access Rates Based on the CALLS Order or a Forward Looking Cost Study*, Order, 17 FCC Rcd 24319, ¶ 23 (2002).

[21] Comments of Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom and Valor Telecommunications, LLC, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173 (filed Dec. 16, 2003)("*Joint UNE Pricing Comments*").

[22] *Joint UNE Pricing Comments* at 3, 6-7.

carriers (7,188 lines) and have invested, on average, 50 percent more per loop and in central office switching and transmission than have non-rural carriers.[23]

Iowa Telecom also explained how depreciation rates in a cost model should be set based on financial records and switch discounts should reflect what can be reasonably expected for mid-size and rural carriers.[24] Similarly, Iowa Telecom discussed how the TELRIC assumption that a carrier will lease certain network elements will not adequately reflect actual costs if leasing network elements is not part of the carrier's network development plans.[25] In fact, as circumstances have developed, Iowa Telecom has had good reason not to lease significant amounts of network elements from other carriers given Qwest's recent 420 percent increase in its dark fiber rate in Iowa.[26]

Further, in its *Joint UNE Pricing Comments*, Iowa Telecom discussed how the Commission's pricing rules should encourage building and maintaining a telecommunications network that meets statutory and regulatory policy goals. This includes cost modeling that reflects the cost of using Carrier Serving Area for loop design, recognizing that replacing small switching offices with digital loop carrier would present particular reliability concerns in rural areas, and the particular rural need for reliable fiber rings.[27]

In a letter to Iowa Telecom included herein as Attachment B, Orren E. Cameron III, the Director of the Advanced Services Division of the Rural Utilities Service ("RUS"), the federal

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[23] *See RTF White Paper 2*, at 44, 49-52.

[24] *Joint UNE Pricing Comments* at 6.

[25] *Id.* at 8.

[26] Qwest formerly provided dark fiber through its Statement of Generally Available Terms and Conditions at $47.09 per fiber pair per route mile per month. On October 1, 2004, Qwest introduced its new "commercial" rate of $198.00 per fiber pair per route mile per month.

[27] *Joint UNE Pricing Comments* at 10-11.

organization with expertise in evaluating the business plans of rural telephone companies, discusses the importance of these and other rural network reliability concerns and the need to recognize differences between rural and non-rural telecommunications networks. Each of the criteria discussed by Mr. Cameron directly affect the costs of rural carriers. Each also would tend to make rural carrier costs higher than those of non-rural wireline carriers, not because non-rural carriers do not provide similar reliability, but because rural carriers generally have far fewer subscribers in each exchange, or in each DLC serving area, than their non-rural counterparts. The Joint Board should endorse these design standards for both loop and interoffice cost study methodologies.

E. Carrier Elections Regarding the High-Cost Support Program and Method By Which Costs Will be Demonstrated Should be On a Study-Area-By-Study-Area Basis.

Commission rules should acknowledge that carriers that have acquired or may acquire exchanges that they operate as part of separate study areas may face varying financial circumstances on a study-area-by-study-area basis. Iowa Telecom, for example, over four years ago acquired exchanges in three different study areas.[28] These exchanges all happened to be previously owned by the same holding company and, therefore, although they were in three distinct study areas, were run similarly. This may not, however, be the case with all mid-sized carriers and may not always be the case for Iowa Telecom. For example, Iowa Telecom may in the future purchase a set of exchanges that Iowa Telecom desires to operate as part of a fourth study area. Because the level of historical investment in such exchanges may be different from

[28] Study areas nos. 351167, 351170, and 351178.

that in Iowa Telecom's current study areas, Iowa Telecom and all other rural carriers should be permitted to make their high-cost support program elections (non-rural versus rural, FLEC versus embedded cost) on a study-area-by-study-area basis.

V. CONCLUSION

For the foregoing reasons, Iowa Telecom respectfully requests the Joint Board to recommend that the Commission permit rural carriers greater flexibility in demonstrating their costs, as well as in electing the universal service high-cost program in which they participate. In particular, the Joint Board should recommend that the Commission permit rural LECs, particularly price cap carriers, to opt out of the rural high-cost support program and, instead, participate in the non-rural high-cost support program. In addition, the Joint board should recommend that the Commission provide carriers participating in the rural high-cost program with the option of voluntarily demonstrating their costs using FLEC in rather than embedded costs using a FLEC methodology which incorporates the unique characteristics of rural carriers.

Respectfully submitted,

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Dated: October 15, 2004

CERTIFICATE OF SERVICE

I hereby certify that, on this 15th day of October 2004, I caused copies of the foregoing Comments in response to the Federal-State Joint Board on Universal Service's Public Notice seeking comment on certain of the Federal Communications Commission's rules relating to high-cost universal service support to be served on the following parties by electronic mail.

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ATTACHMENT A

Comments of Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom and Valor Telecommunications, LLC, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173 (filed Dec. 16, 2003)

Before the
Federal Communications Commission
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In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers	WC Docket No. 03-173

JOINT COMMENTS OF IOWA TELECOMUNICATIONS SERVICES, INC. AND VALOR TELECOMMUNICATIONS, LLC

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December 16, 2003

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SUMMARY

The Commission should recognize the impact of the TELRIC regime on mid-size, rural carriers and enact substantial reforms of the current TELRIC methodology to capture the economics of rural networks. Doing so will allow mid-size and rural carriers to receive adequate compensation for services provided on their networks and will help ensure that Americans living in rural settings are able to enjoy a high-quality, modern, stable and secure telecommunications network.

Specifically, the Commission should base the TELRIC methodology on real world network configurations. Cost modeling should reflect actual carrier plans, recognizing that network configurations vary based on size and type of carrier, the carrier's actual experience, and competition. Cost modeling should not assume that a carrier will lease network elements from other carriers because a number of factors will influence a carrier's actual decision regarding leasing. Cost modeling should also encourage real world network configurations that are designed to meet the policy goals of the FCC, such as ensuring E911 service in rural communities and providing reasonable redundancy and backup protection.

In addition, the Commission's documentation requirements to support a TELRIC cost showing should be reasonable. Transparency and verifiability are important goals for TELRIC cost studies, but the Commission should recognize that small and mid-size carriers can be substantially burdened by overly detailed documentation requirements. FCC documentation requirements should, therefore, be consistent with those in access tariff filings and carriers should be allowed to recover the cost of TELRIC showings.

Finally, switching elements prices should remain traffic sensitive and the FCC need not adopt a productivity factor to adjust TELRIC prices over time.

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IOWA TELECOMUNICATIONS SERVICES, INC.
AND VALOR TELECOMMUNICATIONS, LLC

I. INTRODUCTION

Iowa Telecommunications Services, Inc. ("Iowa Telecom") and Valor Telecommunications, LLC ("Valor") (collectively, "Joint Commenters") hereby submit the following joint comments on the FCC's Notice of Proposed Rulemaking in the above-referenced matter.[1] The Commission has asked for comment on what changes, if any, need to be made to the agency's Total Element Long Run Incremental Cost ("TELRIC") pricing rules, in light of experience gained in the seven years since TELRIC was first adopted.[2]

The Joint Commenters bring an important and unique perspective to this discussion. Iowa Telecom and Valor are both mid-size carriers that serve predominantly rural areas of the country. Iowa Telecom serves approximately 260,000 lines in Iowa, and provides service to only one town with more than 10,000 people. Valor serves about 550,000 lines in the Southwest,

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1 *See* In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, 18 FCC Rcd 18945 (2003) ("*NPRM*").

2 *Id.* at ¶ 1-3.

including Oklahoma, New Mexico, Texas and Arkansas. The Joint Commenters are representative of a new class of specialized mid-sized rural local exchange carriers that have entered the market in the past few years. Both of the Joint Commenters were created through the purchase of former GTE service lines. The Joint Commenters, and other similarly situated ILECs, blend characteristics of smaller, rural carriers and price cap carriers, and thus do not easily fit into either category.

The Joint Commenters believe that the FCC must carefully consider the impact of the TELRIC regime on mid-size, rural carriers such as Valor and Iowa Telecom. It is imperative that mid-size and rural carriers are able to receive adequate compensation for services provided on their networks. Providing fair compensation aids the Commission's universal service goals, and ensures that Americans living in rural settings are able to enjoy a high-quality, modern, stable and secure telecommunications network.

The TELRIC debate is often focused on the concerns of large carriers, such as the former Bell Operating Companies. However, it is critical that the FCC keep in mind that TELRIC has impacts beyond just the nation's largest carriers. For example, rural carriers in certain states, such as Iowa, have not retained the exemption under Section 251(f) of the Act,[3] which means that carriers like Iowa Telecom must provide Unbundled Network Elements ("UNEs") pursuant to Section 251(c), and must do so at TELRIC prices. Valor, as successor to GTE for interconnection agreements in the areas that Valor purchased, undertook GTE's obligations to provide UNEs pursuant to those agreements.[4]

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[3] 47 U.S.C. § 251(f).

[4] Valor has the protection of Section 251(f)(1) in Arkansas, Texas and New Mexico, and 251(f)(2) in Oklahoma.

Moreover, TELRIC can also used for regulations unrelated to UNEs, such as access charges. Iowa Telecom petitioned for forbearance and received authorization from the Commission to price its access charge rates according to TELRIC principles. The experience gained in that proceeding has provided Iowa Telecom with insight into the general benefits and shortcomings of TELRIC pricing. This insight is equally applicable to the use of TELRIC as a UNE costing methodology.[5]

If regulators are to employ the TELRIC methodology in setting prices, it must be crafted to produce reasonable results. However, in order to achieve reasonable outcomes, the FCC must enact substantial reforms of the current TELRIC methodology to capture the economics of rural networks. The experience of the Joint Commenters is that inadequate recognition of the unique nature of rural networks in TELRIC, as currently applied, leads to inadequate results. For example, a methodology that estimates the cost of an efficient rural network by applying fill factors derived from equally efficient but substantially denser urban networks will understate the cost of the rural network. Other assumptions of the hypothetical network are equally skewed to high density carriers, with similar negative impact on rural carriers.[6]

Furthermore, the use of hypothetical efficiencies in TELRIC cost models produces unreasonably low rates, as such efficiencies are difficult or impossible to replicate in the real world. Unreasonably low rates discourage network investment, both by the carrier being forced to charge the rate (who will be unable to recoup the cost of the network) and by the competitor being allowed to pay the rate (who will be unlikely to invest in its own network if a pre-built

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[5] The Joint Commenters focus here on the shortcomings of TELRIC pricing as a UNE costing methodology. The Joint Commenters do not address the appropriateness of TELRIC pricing for interconnection, reciprocal compensation, and intercarrier compensation.

[6] The Joint Commenters are not contending that TELRIC, as currently employed, produces reasonable results for large carriers. The Joint Commenters assert only that TELRIC is not properly implemented for mid-size and rural carriers.

network is available for less cost). Only cost recovery based on forward-looking cost developed with realistic inputs promotes investment, a factor that is particularly important in rural areas.

In order to address these and other problems with TELRIC, the Joint Commenters urge the Commission to follow the recommendations set forth below.

II. THE COMMISSION SHOULD BASE THE TELRIC METHODOLOGY ON REAL WORLD NETWORK CONFIGURATIONS.

A. Cost Modeling Should Reflect Actual Carrier Plans For The Network Over a Reasonable Period Of Time In The Future.

In order to provide adequate compensation for building and maintaining rural telecommunications networks, the Joint Commenters submit that the Commission should use real world network configurations for the TELRIC methodology. Network configurations vary depending on the size and type of carrier, the carrier's actual experience, and competition. The Joint Commenters submit that cost modeling should therefore reflect actual carrier plans for the network over a reasonable period of time in the future.

1. Cost modeling should reflect different cost characteristics between carriers.

It is well established that smaller carriers experience higher costs than large carriers and that rural carriers experience higher costs than non-rural carriers, a fact that the Commission has recognized on several occasions. For example, in 2001 the Commission observed that rural carriers "generally have higher operating and equipment costs" than non-rural carriers, due to "lower subscriber density, smaller exchanges, and a lack of economies of scale."[7] The Commission is also familiar with some of the key differences in the operating parameters facing rural and non-rural carriers. In 1998, the Federal-State Joint Board on Universal Service

[7] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, 16 FCC Rcd 11244, ¶ 5(2001).

appointed a Rural Task Force, which included AT&T among its members, to study the differences between rural and urban carriers. The Rural Task Force issued a number of white papers on various issues affecting rural carriers, but its second White Paper, entitled "The Rural Difference,"[8] focused on the distinct cost characteristics that this group of LECs face. Among other points, the White Paper noted that rural carriers serve far fewer lines per local switch (on average about 1,250 lines) than non-rural carriers (7,188 lines).[9] The Rural Task Force determined that the average rural carrier central office switching and transmission investments are 50% higher per loop than for non-rural carriers.[10] In addition, the Rural Task Force observed that rural carriers have a smaller percentage of local calling than non-rural carriers, serve areas with low population densities, lower income populations, and fewer business and high-volume customers, and face substantially higher plant specific and operations costs.

Given these varied cost characteristics between types of carriers, rural carriers must account for their higher costs when conducting network planning. The Joint Commenters therefore believe that cost modeling that reflects a carrier's actual network plans will provide more adequate cost recovery and encourage investment in rural telecommunications networks. Similarly, because carriers face such different costs, cost modeling that avoids the use of benchmark factors or data from carriers dissimilarly situated with the mid-size or rural carrier will also provide more reasonable compensation.

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8 *The Rural Difference*, Rural Task Force White Paper 2, Jan. 2000, at http://www.wutc.wa.gov.rtf.

9 *See id.* at 44.

10 *See id.* at 49-52.

2. Cost modeling should reflect a carrier's actual experience.

Because actual network plans also vary depending on a carrier's operating experience, cost modeling should reflect a carrier's actual experience. Thus, depreciation rates in a cost model should be set based on financial records, fill factors should reflect the carrier's experience, and structure sharing assumptions and switch discounts should reflect what can be reasonably expected for mid-size and rural carriers.

First, depreciation rates should be set based on financial records instead of using regulatory-based depreciation rates. The Joint Commenters submit that the actual retirement experience of an ILEC and the actual depreciation rates experienced by an ILEC are very relevant to efficient cost modeling. Setting depreciation rates based on financial records will better measure anticipated changes in the efficiency of equipment by using the actual investment patterns and asset lives reflected in financial records. It is well known that regulatory depreciation lives fail to keep pace with real-world obsolescence and become quickly outdated.[11]

In addition, because fill factors vary based on size of carrier, they also significantly affect a carrier's cost. Fill factors in the TELRIC model should therefore reflect a carrier's actual experience. As an example, the Joint Commenters note that 6% is generally considered a reasonable amount of spare switching capacity in the large central offices typically included in a RBOC TELRIC study. For a central office with fewer lines, however, administrative fill factor

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[11] *See, e.g.*, In the Matter of 1998 Biennial Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket No. 98-137, Comments of SBC Communications, Inc. (filed April 17, 2000) (stating "Depreciation prescription was an important regulatory rate-setting tool that served regulators well in an era where competition was minimal, technological changes came slowly and the rate-setting process was used to accomplish important social goals. Today, however, competition is robust and, as a result of that greatly increased level of competition, technological change comes very quickly. It is the competitive market demand for the newest features and functions that controls the economic life of telephone equipment today, rather than the durability of that equipment. The public interest is ill-served by retention of an outdated regulatory process that periodically locks in place externally and arbitrarily imposed lives for telephone equipment, rather than allowing price-cap ILECs to use the economic lives now determined by the forces of competition, as do their competitors.").

percentages in a cost model should be higher in order to reflect the different costs associated with these smaller offices.[12] As the Commission knows, a 4,000-line office, which may be a large office for a rural carrier, is still small when compared to most urban offices and a carrier may need more spare in its smallest remote locations.

Finally, structure-sharing assumptions and switch discounts should reflect what could reasonably be expected for mid-size and rural carriers. In particular, structure-sharing assumptions should be based on actual structure sharing ratios experienced by the carrier in the market for which pricing is being set. Switch discounts should reflect the reasonable discount that a rural carrier, with lower switch capacity requirements than an urban carrier, can expect to receive. Using urban assumptions regarding structure sharing and switch discounts is unreasonable and does not adequately reflect the carrier's cost recovery needs.

3. Cost of capital should reflect the existence of competition.

Although the FCC should reform the TELRIC methodology to reflect actual carrier network plans, the Commission should still allow state commissions to calculate cost of capital based on the existing competitive risk associated with the network. Doing so will better reflect real world network configurations and provide more nearly adequate compensation for investment. The Commission has already stated in the *Triennial Review Order* that a TELRIC-based cost of capital should reflect the risks of a competitive market.[13] Including competition in the cost of capital reflects the real risk of losing customers to other facilities-based carriers.

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[12] For example, Iowa Telecom calculates a particular spare capacity factor in its 14 largest central offices, each of which has 4,000 or more working lines. In its smaller offices, however, Iowa Telecom needs to utilize a different spare capacity factor. Iowa Telecom needs more spare facilities in its smallest remote locations for efficiency purposes, *e.g.*, to avoid trips across the state to pick up parts when a card fails. More spare facilities use more office capacity in a small office and therefore result in different spare capacity factors. *See* In the Matter of Iowa Telecommunications Services, Inc. Tariff FCC No. 1, Transmittal No. 31, WC Docket No. 03-135, Rebuttal of Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom at 21 (filed July 21, 2003).

[13] *Triennial Review Order* at ¶¶ 680-84.

Even if the TELRIC methodology is modified to reflect actual carrier network plans, this competition and the risk of losing customers will still exist, and the cost of capital should reflect this competition. The Commission should therefore uphold its original determination that cost of capital should be calculated based on existing competitive risk.

B. The Commission Should Not Include The Cost Of Leasing Network Elements From Another Carrier In Its Analysis Of Cost Efficiency Unless Leasing Is Part Of The Carrier's Network Development Plans.

In order to reflect real world network configurations in cost modeling, the Commission should not assume that a carrier will lease network elements from other carriers. The assumption that a carrier will lease certain network elements will not adequately reflect actual costs if leasing network elements is not part of the carrier's network development plans. In reality, a number of factors could cause a carrier to choose not to lease network elements as part of its network development plans. These factors include network control and service quality, the potential impact of future network reconfiguration, and the generation of revenues for network reinvestment. Moreover, there is no evidence that a carrier leasor would be willing to make the infrastructure investment to grow or modernize network elements that may be necessary to provide efficient services for the leasing party's traffic.

For example, AT&T has previously chastised Iowa Telecom for developing a plan to augment its own interoffice facilities rather than using facilities leased from Qwest, even when leasing such facilities would be unreasonable for Iowa Telecom from an operational standpoint.[14] However, carriers must be given the freedom to recover the costs of constructing their own network facilities. A third party carrier cannot be expected to design and build a network with the needs of another carrier, or its customers, in mind. There is simply no economic incentive

[14] *See* In the Matter of Iowa Telecommunications Services, Inc. Tariff FCC No. 1, Transmittal No. 31, WC Docket No. 03-135, Rebuttal of Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom at 21 (filed July 21, 2003).

for a carrier to do so. Requiring small and mid-size carriers to rely on the facilities of larger, neighboring carriers would create a great deal of long-term uncertainty, in addition to depriving the small and mid-size carriers of the ability to custom tailor their networks to meet their customers demands. Moreover, as the FCC has recognized, there is a strong need to promote facilities deployment, especially in rural areas.[15] There can be no clearer way of thwarting additional facilities investment than by adopting cost recovery rules that postulate using another carrier's network.

C. The FCC Should Encourage Building And Maintaining A Telecommunications Network That Meets Statutory And Regulatory Policy Goals.

The TELRIC methodology implemented by the Commission must be consistent with FCC policy goals, and the Commission should encourage investment that meets the policy goals of the Commission. For example, the FCC should not reject a network configuration or costs on "efficiency" grounds if the investment is designed to ensure that there is reliable E911 service in rural communities. Additionally, the FCC should not reject a network configuration or costs on "efficiency" grounds if the investment is designed to provide reasonable redundancy and backup protection in case of disasters or cable cuts. By basing the TELRIC methodology on real world network configurations that meet the policy goals of the FCC, the FCC will more adequately compensate carriers for real investment. The Commission must avoid creating perverse

[15] For example, in the *RTF Order*, the Commission stated that it was "reasonable to reevaluate and re-base the high-cost loop support fund to ensure that rural telephone companies have incentives to maintain existing facilities and make prudent investments in facility upgrades." Federal-State Joint Board on Universal Service Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, 16 FCC Rcd 11244 at para. 43 (rel. May 23, 2001). Similarly, in the *MAG Order*, the Commission recognized that "[b]y rationalizing the rate structure for recovery of interstate-allocated loop costs, we are fostering competition for residential subscribers in rural areas by facilities-based carriers." Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, 16 FCC Rcd 19613 at para. 11 (rel. Nov. 8, 2001).

incentives that would encourage carriers to build networks without the proper levels of redundancy and security.

1. Cost Modeling should reflect the cost of using Carrier Serving Area ("CSA") as the loop design standard.

The Joint Commenters submit that cost modeling that reflects the cost of using CSA as the loop design standard will appropriately recognize that CSA is the most widely used standard for designing copper loops.[16] For rural carriers in particular, CSA is an efficient standard because CSA supports broadband access up to 1.54 Mbps using DSL technology. Further, by legislative mandate, the Rural Utility Service requires 1.0 Mbps capability in the local network plant designs it approves.[17] Cost modeling that reflects the cost of using CSA for loop design therefore reflects the realistic cost to ensure that loops in rural areas support the same range of services, including broadband access, as do loops in urban areas.

2. The TELRIC methodology should reflect the cost of maintaining the minimum services that must be supported in a rural central office.

The Joint Commenters also submit that cost modeling should reflect the actual cost for a carrier to maintain minimum services in its central offices. The ability to place a call, even if only to a neighbor, is an essential characteristic of local service, and a characteristic consistently available to urban customers located in larger exchanges. The Commission should, therefore, encourage investment that ensures this same minimum service for rural customers.

To encourage such investment, the TELRIC methodology should recognize that maintaining minimum service imposes different costs and requirements on rural carriers than on urban carriers. For example, Iowa Telecom has over 150 exchanges with fewer than 500 active

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[16] *See* "Advanced Telecommunications in Rural America," a joint report prepared by NTIA and RUS, April 2000.

[17] 7 C.F.R. § 1751

lines. Almost every exchange is served by a remote switch module that subtends a distant host switch. Many of these small offices could be replaced by digital loop carrier. If the switches were removed, however, subscribers in those exchanges would no longer be able to place local calls if the transport facility were cut. These subscribers would, in effect, receive inferior service in comparison to the urban customer. By implementing cost modeling that reflects the true costs of providing minimum service standards, the Commission will recognize that maintaining minimum service standards requires maintaining minimum switching capacity for very small exchanges. By compensating carriers for these costs, the Commission will reaffirm its commitment to the principal that rural customers should receive services comparable to those offered to urban customers.

3. Cost modeling should reflect the actual cost of fiber ring architecture to ensure transport redundancy.

The Commission should also recognize that including fiber ring architecture in network plans is essential to ensure transport redundancy for both urban and rural carriers. Urban interoffice transport networks (and often intraexchange feeder networks) feature a fiber ring architecture as an essential element of a reliable telecommunications network. In the rural context, similar rings are even more essential because a rural exchange may be served by a remote switch or even just by digital loop carrier. These rings should assure two diverse routes into each central office. In order to encourage investment that is designed to provide reasonable redundancy, the TELRIC methodology should reflect the actual cost of providing fiber ring architecture for interoffice transport.

III. THE FCC SHOULD REQUIRE ONLY A REASONABLE AMOUNT OF DOCUMENTATION TO SUPPORT A TELRIC COST SHOWING.

A. Cost Studies Must Be Transparent and Verifiable

The Joint Commenters support the Commission's goals of ensuring that TELRIC cost studies are both transparent and verifiable.[18] In order to provide the highest possible level of confidence in TELRIC rates, both competitors and the state commissions charged with administering pricing proceedings must be able to understand the inputs and formulae used in a particular cost model, and verify that those elements are correctly selected and rendered.

A transparent and verifiable cost study promotes regulatory efficiency. As the Commission suggests in the *NPRM*, where data is derived from publicly available or otherwise easily verifiable sources, necessary audits and decision-making can take place without excessive cost or delay.[19] The complexity and length of state TELRIC proceedings can be a severe financial drain on state regulators and telecommunications stakeholders, including both incumbents and competitors. As mid-size carriers, the Joint Commenters are acutely aware of the financial burden that these drawn-out rate proceedings can impose, both in terms of actual money and time invested and in terms of long periods of regulatory uncertainty. Valor's experience in New Mexico is instructive. Despite a lack of demand for UNEs, the New Mexico Public Regulation Commission has decided to undertake a cost proceeding that will require Valor to hire outside counsel, hire outside cost modeling experts, and tie up significant internal resources. Valor estimates that it will cost the company more than $500,000 to complete the cost study, while the annual revenues from UNEs in New Mexico are a fraction of this amount.

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[18] *NPRM*, ¶ 41.

[19] *Id.*

B. FCC Documentation Requirements Should Be Reasonable and Consistent With Those in Access Tariff Filings.

While transparency and verifiability are important, the Commission must also be mindful that overly detailed documentation and proof requirements can impose substantial challenges on small and mid-size carriers. Mid-size carriers do not have the same level of regulatory staff and budget that larger RBOCs do. Providing voluminous supporting documentation, and responding to challenges of even the most basic information, can place a large strain on these carriers.

The implementation of TELRIC in different manners by different state regulators has increased the number and complexity of regulatory proceedings at the state and federal level that carriers must engage in. At the same time, increased competition has created a larger pool of interested parties, meaning that even straightforward matters at the state level or the FCC can turn into protracted battles where carriers vie for competitive advantage. As a result, these proceedings often develop a logic and cost of their own, out of proportion with the actual economic impact of the issue being considered. Cases involving small amounts of money can snowball rapidly, causing carriers to spend far more justifying and challenging cost models than is at stake in the proceeding. For example, when Iowa Telecom submitted a TELRIC cost study to support its access rates earlier this year, the regulatory cost added up to hundreds of thousands of dollars due to detailed documentation and data requirements. This cost was far out of proportion to the relatively low revenues affected by the filing.

The Commission need not exacerbate the problems with regulatory complexity by imposing unreasonable documentation requirements. Such requirements for supporting documentation can draw out these already lengthy proceedings, draining resources that would be better spent by both the incumbent and the competitor on providing service to their respective customers.

The Commission should strive to ensure that the supporting documentation requirements do not impose an excessive burden. These requirements should be consistent with those that have been established in access tariff filings, which provide the Commission with all of the requisite information while not working a hardship on the carriers involved.

Moreover, the FCC should establish that affidavits submitted by company executives are adequate evidence of the actual network plans of the carrier. Affidavits, which are submitted under penalty of perjury, can provide the Commission with a high degree of comfort that the information submitted is accurate. For matters such as the future network plans of the carrier, which are not easily susceptible to objective verification through other sources, affidavits provide the best evidence available. Allowing endless challenges to such affidavits, or requiring that carriers produce something beyond the testimony of the personnel charged with making planning decisions, would unnecessarily bog down the regulatory process, and would be a waste of both agency and carrier resources.

C. The Commission should create and maintain a set of safe harbor inputs for a TELRIC model.

Parties in TELRIC cost proceedings often spend seemingly endless hours debating the numerous input values needed for a TELRIC study. Yet, the Commission and state commissions have already approved the same or similar input values in the numerous TELRIC cases that have been decided in the past seven years. For administrative efficiency, the Joint Commenters submit that the Commission should establish a file of these already-approved inputs and find that inputs taken from this set of already-approved inputs are a safe harbor for use in subsequent TELRIC cases. Although a carrier could still choose to establish its own values based on its own plans and experience, parties using values from the Commission's file would know that those values are considered valid. These safe harbor values should not, however, be established as

presumptively valid, and a carrier using its own values, based on its own plans and experience, should not have to bear any special burden of proving that its own value is proper. To require a carrier using its own value to bear a special burden would undermine the benefit of reforming TELRIC to establish rates using actual network plans. Instead, the already-approved inputs would merely be used for administrative efficiency, allowing parties using the already-approved inputs to only debate variances from the approved values.

D. Carriers Should Be Allowed To Recover the Cost of TELRIC Showings

At the state level, carriers are routinely able to recover the cost of participating in rate cases.[20] TELRIC cost showings can impose burdens similar to or even greater than state rate cases, and thus can lead to the same type of extraordinary expenditures by carriers. There is no reason that the costs of these complex and expensive regulatory showings should not also be recoverable in some fashion from the carrier's UNE customers, regardless of the type of regulatory structure a state may have. The Commission should make an allowance for this cost recovery in its revised TELRIC rules.

IV. SWITCHING ELEMENT PRICES SHOULD REMAIN TRAFFIC SENSITIVE

The Commission's long-standing practice has been to treat local switching as generally traffic sensitive, and to require recovery of the majority of switching costs through traffic

[20] It is widely recognized that rate case expenses should be included in a utility's rate base when determining what constitutes "just and reasonable" rates. *See* Charles F. Phillips, Jr., *The Regulation of Public Utilities*, p. 261 (3rd ed. 1993), and cases cited therein. *See, e.g., Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 120-21 (1939) (stating "Even where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness, we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission.").

sensitive charges.[21] The only switch costs that have traditionally been recoverable on a non-traffic-sensitive basis are line side ports and dedicated trunk ports.[22]

The decision of the Wireline Competition Bureau in the Virginia arbitration proceeding to mandate recovery of switching costs through non-traffic sensitive charges thus represents a radical departure from FCC precedent.[23] The Commission should decline to follow the Bureau in allocating additional switch costs to non-traffic-sensitive rates based on available capacity or other fixed cost assumption. The costs of switch processors and common equipment are effectively shared costs, and in a competitive market a firm would recover these costs from its different services based on the conditions and characteristics of the market. There is no reason to believe that in such a situation these costs would be recovered through non-traffic-sensitive charges. Indeed, it is logical to assume that a competitive firm would recover such costs through traffic sensitive rates, in order to reduce the size of the non-traffic-sensitive costs that a customer must pay, and to send the correct economic signals to a carrier regarding increased usage of switching capacity.

V. THE FCC NEED NOT ADOPT ANY SPECIFIC METHODOLOGY TO ADJUST TELRIC PRICES OVER TIME.

The Commission should not use a productivity factor to adjust TELRIC prices over time. Doing so is wholly inconsistent with the theory and methodology of establishing TELRIC pricing based on actual network configurations. In fact, a forward-looking pricing model

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[21] *See, e.g.,* 47 C.F.R. § 69.106; In the Matter of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, 17 FCC Rcd 10868, 10873 (2002); In the Matter of Material to be Filed in Support of 2002 Annual Access Tariff Filings, 17 FCC Rcd 8019, Appendix B (2002).

[22] *See* Access Charge Reform, 12 FCC Rcd 15982, ¶¶ 125-127 (1997), *aff'd sub nom Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998).

[23] In the Matter of Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., 18 FCC Rcd 17722, ¶¶ 463-468 (2003).

inherently builds a productivity factor into its formula by projecting future costs (including any cost savings). Any subsequent pricing adjustments can be accomplished through renegotiation of interconnection contracts or revisions to rates after a reasonable period of time, just as any other rate changes are handled today. If the TELRIC model meets the Commission's stated goal of having data derived from publicly available or otherwise easily verifiable sources, then model results can be updated more reliably on a periodic basis when necessary, rather than using arbitrary productivity adjustments.

The claim that a productivity factor is necessary to prevent a cost model from becoming "increasingly overstated" is directly at odds with established economic theory recognized in prior Commission decisions. By definition, a forward looking cost model cannot be "overstated" because it represents the theoretical cost-based rate that would be achieved in a competitive market. Forward looking rates thus take into account reasonably expected gains in efficiency. A separate productivity factor would essentially double count these expected gains and would drive the model's predicted costs below FLEC, and thus below an economically sustainable level. Repeated application of an annual productivity factor, of course, would compound the problem. In short, rather than being a necessary tool to prevent overstatement of costs, a productivity factor would force a carrier to provide access services at an economic loss.

The Commission therefore should decline to establish a productivity factor. If TELRIC rates prove at a future date to have lead to understating productivity gains, the rates can be adjusted at that time.

VI. CONCLUSION

The Joint Commenters ask the Commission to carefully consider the impact of the TELRIC regime on mid-size carriers such as Valor and Iowa Telecom and to ensure that rural carriers are able to receive adequate compensation for services provided on their networks. For the reasons set forth above, the Joint Commenters urge the Commission to follow the recommendations provided in these comments.

Respectfully submitted,
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ATTACHMENT B

Letter Orren E. Cameron III, Director, Advanced Services Division, USDA Rural Development, To David N. Porter (March 3, 2004)

USDA

United States Department of Agriculture
Rural Development

Rural Business–Cooperative Service • Rural Housing Service • Rural Utilities Service
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MAR - 3 2004

Mr. David N. Porter
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Thank you for your inquiry regarding the policy of the Rural Utilities Service (RUS) on reliability of local telecommunications service in these times of evolving network architecture. Of particular concern is our response to decentralized central office switching processing (loop concentrator/remote switch application), and to a lesser extent, the concentrating of central office switch processing to above the end-office level (converting class 5 switches into remote switches). Both of these switching evolutions increase hardware efficiency but in doing so make possible switches that lack sufficient intelligence to continue calling among lines they service should their connection to a higher-order switch be severed.

In 1994, as Director of the RUS Telecommunications Program's Telephone Standards Division, I served as the Agency's representative on an interagency task force, the Reliability and Vulnerability Working Group. This was part of the National Information Infrastructure initiative, and our charge was to assess and make recommendations to ensure the reliability of telecommunications services provided by all known technologies. I was on the Reliable Services for General Users Subgroup, which had representatives from the Federal Communications Commission, the General Services Administration, the United States Postal Service, and the Defense Information Systems Agency, and assessed reliability of services provided to the public. These activities sharpened my interest in telecom reliability.

When digital switching came onto the scene in the late 1970's, the Rural Electrification Administration (REA, predecessor to the Rural Utilities Service) immediately identified the conversion of a Class 5 electromechanical switch to a remote switch as a threat to service reliability. In early 1980, REA addressed remote switch vulnerability by establishing a reliability policy.

When an exchange switch was replaced with a digital switching device, that new device had to be equipped with stand-alone capability, or fed by a connection that had duplicative routing. This was enforced in the design stage, via comments from our Engineering Branch upon reviewing a system design submitted in support of a loan application. Since there were two possible solutions to the concern, we did not require in the central office equipment specification

that smart remote capability *always* be provided, but we did require every listed COE manufacturer to offer the option of stand alone capability for remote switches. This requirement may have forced many manufacturers to develop standalone capability for the remote switch devices they intended to market to rural LECs.

In the 1990's, rural LECs began building their interexchange connections using ring configurations. They were very aggressive about this; we never had to require it. Very few rural LECs are not today using ring configuration, and those who are not will have taken some other step to ensure reliability.

Many factors bear on route diversity and route vulnerability. We have a tradition of rural LECs burying plant deeper than national standards require or recommend. Generally, a minimum of 24" depth is required for buried cables. We require only that depth, but our LECs generally standardize on 30" for local loop cables, and 36" or greater for interexchange facilities, and for important loop carrier feeders. I do not remember ever, in my 33 years, needing to suggest that a borrower bury a facility deeper than they proposed, but I remember many battles over extreme depths such as 48" that were proposed in plans and specifications. In reality, we have very few cable cuts in critical facilities due to this. During construction, it is normal practice for our resident engineers and inspectors to carry depth rods to use to punch down to the cable to ensure minimum depth. I did this on my many construction inspections during my Field Engineer years from 1974 through 1980. I never found a shallow cable. When the first Network Reliability Council's 1993 *Report to the Nation* was published, we were surprised to learn that LECs were actually burying plant at less than 24" depth.

There was a circumstance where we did not require those steps to maintain service reliability. In places where there is no community of interest in an exchange, such as, no local police or emergency response presence, no business presence or local government, and no true cluster of households, no school, no church, we did not require smart remote capability. With the evolving capability of E-911 services, perhaps we should revisit this.

Today, we have such a good reliability record that our Engineering Branches do not feel it necessary to make requirements to ensure it. Our regulations and policies do not contain requirements to solve these problems. We still require that switch manufacturers offer standalone remote switch capability. We fund ring configurations as a rule. When new reliability recommendations come out from the industry I smile and speak on them at the next RUS Telecommunications Symposium – we already exceed them.

Digital line carriers which serve subparts of exchanges pose similar reliability issues, but benefit from the same robust plant practices that I have mentioned. In addition, our borrowers have battery reserve or mobile emergency power generators to keep these going if they serve reasonably large numbers of customers. Our guiding rule has been that we don't want plant modernization to reduce the reliability of service. Yes, a cable cut has always had the ability to isolate even a large number of customers ("large" to us is, say, 25 or more). And that same cable cut would have the ability to isolate a similar group of customers if they were served by

carrier. So we can't guarantee that every customer will always have service, but we don't trade reliability for modernization.

We have moved on to the next threat to telecom reliabiltiy - local powering of service. The State Modernization Plan requires, in §1751.106(h): "(h) The Modernization Plan must make provision for reliable powering of ordinary voice telephone service operating over those portions of the telecommunications network which are not network powered. In the event of electric utility power outages, an alternative source of power must be available to ensure reliable voice service." As with the switch and feeder route policies of two decades before, I authored this provision. The rural LEC industry has embraced reliable powering and today we fund standby power for remote switches all over rural America.

This will be a defining difference between wireline telephony and Voice over Internet Protocol and other new forms of telephone service emerging today. I gather from their public statements, the ILEC industry has figured that out, and will advertise the reliability of wireline service as a feature. It is ironic that an industry that has been obsessed with reliability for over 50 years, is finally boasting about it.

Sincerely,

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